No. 90-1551

Supreme Court, U.S.
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1990

HOLYWELL CORPORATION, *et al.*,
Petitioners,

v.

BANK OF NEW YORK and
FRED STANTON SMITH,
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Eleventh Circuit

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REPLY BRIEF FOR THE PETITIONERS

DENNIS G. LYONS
Counsel of Record
1200 New Hampshire Avenue, N.W.
Washington, D.C. 20036
(202) 872-6700

Of Counsel:
ARNOLD & PORTER
Washington, D.C., and
New York, New York

STUART E. SEIGEL
KENT A. YALOWITZ
65 East 55th Street
New York, New York 10022
(212) 750-5050
Attorneys for Petitioners

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APPENDIX

In re Holywell Corp. (United States v. *Bank of New York)*, No. 91-0953-CIV-RYSKAMP (S.D. Fla. May 16, 1991) 1a

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REPLY BRIEF FOR THE PETITIONERS

1. *This Case Emerges from the Same Scheme as that Revealed in the Tax Case.*—In its brief opposing certiorari on our petition and that of the United States in Nos. 90-1361 and 90-1484 (the "tax case"), the Bank of New York ("Bank" or "BNY") admitted—indeed appears to have boasted—that the purpose and intent of its Plan of Reorganization was the avoidance of taxes. The Bank's purpose was to be fulfilled by the appointment of a trustee with powers similar to those of an ordinary bankruptcy trustee—to act under court supervision, to give bond, to sue and be sued, to deal with the trust assets in any lawful manner—but who (unlike any other kind of trustee of insolvent estates) was not to pay federal income taxes. Indeed, the Bank's brief in opposition to certiorari in the tax case indicated that this was one of the primary purposes of the Plan and, if the Plan were not so construed, its fundamental purpose would be frustrated. BNY Br. (Nos. 1361, 1484) 3, 9, 14-16, 27. The trustee put it even more strongly, asserting that the Plan "does not *permit* payment of the taxes." Smith Br. (Nos. 1361, 1484) 8 (emphasis added).

The present case involves an unlawful provision in the Plan under which the Bank's claim for postpetition interest—despite the Bank's status as an undersecured creditor—is to take precedence over the claims of all other creditors, including that of the United States for federal income taxes, since the trustee was not going to pay taxes at all. The respondents here take the position that the bankruptcy doctrine of "mootness" insulates this unlawful provision of the Plan from any judicial scrutiny. They urged this, too, as a reason for not granting certiorari in the tax case—namely that the Plan meant and intended that taxes not be paid and that it was too late to question this. BNY Br. (Nos. 1361, 1484) 15-16; Smith Br. (Nos. 1361, 1484) 17-18. Here, they make this "mootness" argument on the ground that the Plan was

consummated through the sale of the Miami Center project to the Bank's nominee at a time when the present petitioners were protesting the unlawful provision in the Plan but, like most bankruptcy debtors, did not happen to have $50 million to put up a bond to stay the consummation of the Plan.[1]

Thus, the United States (not a party to this case) observed in its Reply Brief in the tax case that the "question whether this bankruptcy concept of 'mootness' should be applied to foreclose appellate review of objections to a plan that were made before confirmation is currently pending on petition for a writ of certiorari in *Holywell* v. *Bank of New York*, No. 90-1551 (filed Apr. 8, 1991)." Reply Br. (No. 1484) 7 n.8.

It appears clear that the two aspects of the Plan—(1) the trustee's and the Bank's position that neither the Plan nor the law requires—indeed permits—the trustee to pay federal income taxes, and (2) the express provision of the Plan that the Bank's unsecured claim for postpetition interest is to be paid as if it were secured—are part of the same scheme. If we and the United States prevail in the tax case, a denial of review of the judgment in this case would mean that instead of the Government's claim for taxes coming first (either as an administrative expense under 11 U.S.C. §§ 503(b)(1)(B) and 507(a)(1) if the trusteeship is viewed as part of the bankruptcy case, or under 31 U.S.C. § 3713(a) if it is viewed as something separate from the bankruptcy case), the $27 million in postpetition interest the Bank received will take precedence as a secured claim over the claim for taxes.

The limited assets in the Trust currently amount to about $25 million. Taxes for just one year, with penal-

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[1] A difference between this case and the tax case is, of course, that in the tax case the Court of Appeals for the Eleventh Circuit held that the mootness doctrine was not applicable. Pet. App. (No. 1361) 7a; 911 F.2d at 1544. In this case, without discussion, the court of appeals reached the opposite conclusion. Pet. App. 2a.

ties and interest, relating to Holywell, are estimated by the IRS to exceed $33 million. Reply Br. (No. 1484) 7 n.7. Therefore, effective relief will not be available out of the Trust's assets unless the postpetition interest taken by the Bank is restored. At the same time it is (as the trustee concedes) "curious[]" (Smith Br. 7) that the Bank recovered every penny of principal, prepetition interest and postpetition interest, though "undersecured" and "fac[ing] a substantial loss." Pet. App. 12a, 15a.[2]

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[2] A recent decision by District Judge Ryskamp in *In re Holywell Corp. (United States* v. *Bank of New York)*, No. 91-0953-CIV-RYSKAMP (S.D. Fla. May 16, 1991) (App. hereto), shows another device, like the postpetition interest credit, that the Bank is attempting to use to exhaust the assets of the Liquidating Trust and prevent them from being available for the payment of taxes should we and the United States prevail in the tax case. Without notice or hearing (App. 3a), the Plan of Reorganization was amended to provide for the issuance of a Trustee's Certificate to the Bank in the event that certain elements of the Bank's Plan were reversed and, as a result, the trustee requested a loan from the Bank. Although the reversal occurred (because these elements of the Plan did not meet the fair and equitable standard), *see In re Holywell Corp. (Olympia & York Fla. Equity Corp.* v. *Bank of New York)*, 913 F.2d 873, 879-81 (11th Cir. 1990), no such loan was ever made. Instead, the Eleventh Circuit required the Bank to pay the unfairly treated creditor directly. Nonetheless, by order entered May 2, 1991, the bankruptcy judge granted the Bank's motion for the issuance of a Trustee's Certificate in the amount of $22,128,484—without "any findings of fact or . . . any legal analysis" (App. 4a). (The same bankruptcy judge's conclusion that is the subject of the present petition—that the Bank was not undersecured—was also unaccompanied by any findings of fact or conclusions of law (Pet. App. 11a).) The Trustee's Certificate was interpreted by the Bank and the trustee to be paramount in right of payment to all other claims against the liquidating trust, including tax claims.

Judge Ryskamp granted a stay of the bankruptcy court's order. He viewed the bankruptcy court's confirmation of the Bank's amendment without notice or a hearing to be "a matter of serious concern," App. 3a; and he responded to our and the United States' contention that if the Trustee's Certificate is issued the "United States will be unable to collect taxes due to the depletion of funds held by the trustee," by concluding that "the potential damage to

The two cases—the tax case and the present petition—both relate to parts of the same scheme, according to the Bank's own admissions. That scheme is and was an unlawful scheme. It seems to be only the fact that the Bank concealed its intent about the taxes from the court of appeals that caused that court to apply the mootness doctrine to the present case and not to the tax case as well.

2. *This Court has Jurisdiction to Review.*—Respondents mistakenly contend that the court of appeals' use of the word "moot" in its refusal to adjudicate the merits of this case strips this Court of jurisdiction. Smith Br. 19-20; BNY Br. 11-14. That mistake stems from their confusion of two fundamental and distinct concepts that shape the jurisdiction of the federal courts: Article III's preclusion of adjudication where there is no longer a live "Case[]" or "Controvers[y]" between the parties; and Congress' powers to legislate substantively on bankruptcy matters (Article I) and to control the jurisdiction of the courts (also Article III). The former concept (constitutional mootness) is not involved in this case: nothing has occurred that has eliminated the dispute between the litigants in this Court or otherwise made adjudication of this dispute inconsistent with the adversarial process. *Compare, e.g., Deakins* v. *Monaghan*, 484 U.S. 93, 199-201 (1988); *Golden* v. *Zwickler*, 394 U.S. 103, 108-09 (1969). Instead, it is the Eleventh Circuit's common-law expansion of the latter concept (congressional control of substantive bankruptcy law and federal court jurisdiction)[3] that is at issue here. *See* Pet. 15. The fact that the court of appeals has refused to adjudicate this dispute—for policy reasons alone—

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the United States is severe and likely irreparable." App. 4a. We submit that similar considerations are applicable to this Court's consideration of the petition in the present case.

[3] The statutory provision is section 363(m) of the Bankruptcy Code, 11 U.S.C. § 363(m) (Pet. 3), which expressly provides that (without a stay) reversal on appeal does not affect the validity of certain sales of property approved by the bankruptcy court.

does not deprive this Court of jurisdiction should it decide to exercise it to review that refusal.

3. *There is a Real Conflict of the Circuits.*—Perhaps because they have confused these two concepts, respondents fail to reconcile the two lines of cases in other courts of appeals that conflict with the judgment below. First, at least one court has—unlike the Eleventh Circuit—declined to expand the bankruptcy "mootness" doctrine beyond the statutory language of the Bankruptcy Code that establishes it. *In re Joshua Slocum Ltd.*, 922 F.2d 1081, 1084 (3d Cir. 1990). In the present case, of course, it is common ground that the statutory preclusion does not apply. Pet. 18-20. While respondents spend considerable energy distinguishing the *facts* of the *Joshua Slocum* case (Smith Br. 13-16; BNY Br. 16-17), the conflict presented by that case is the legal issue whether the statute may be applied where, by its express terms, it does not purport to preclude judicial scrutiny. The *Joshua Slocum* court expressly declined to extend the "mootness" doctrine beyond the limits of the statute's language. 922 F.2d at 1084. The Eleventh Circuit has done just that. *See* Pet 19.

Moreover, several courts of appeals have declined to apply the bankruptcy "mootness" concept to cases where all necessary parties are before the court and the court is able to fashion effective relief. *See* Pet. 22-24. Here, it is agreed that nothing prevents court-ordered disgorgement of the unlawfully taken credit—no third party will be adversely affected. It is remarkable that the Bank contends (BNY Br. 13) that it somehow has "changed its position" by having received a deed of the property on which it had a mortgage as a result of the centerpiece of the Plan of Reorganization that it proposed. It hardly is the case that deeding property to the first mortgagee on a property involves a change of position on the part of the recipient, though it surely did on the part of the debtors; one would think this was similar to the consequences of a strict foreclosure by a mortgagee (as con-

trasted with a foreclosure sale to a third party) outside of bankruptcy or reorganization proceedings.

The trustee completely ignores the conflict between the decisions of the D.C., Sixth and Ninth Circuits and the decision below. The Bank does not address it either, except to state that the Eleventh Circuit has cited some of the conflicting cases decided by the other circuits. But the Bank does not dispute that the Eleventh Circuit has here departed from the case-by-case approach of the other circuits and instead applied its own version of the "mootness" doctrine to flatly preclude any sort of judicial review following implementation of a reorganization plan—whether or not all necessary parties are before the court and whether or not effective relief can be granted without adversely affecting third parties.

4. *The Petitioners Have Been Deprived of Appellate Review of the Only Judgment Holding that the Bank was Not Undersecured.*—The Bank provides a lengthy description of the number of appeals that have been taken in this entire corporate reorganization and the length of the reorganization (more correctly, liquidation) proceedings, presumably to prevent the grant of certiorari by creating an impression of weariness and *deja vu*. BNY Br. 1-2, 10. But what cannot be concealed is the fact that at the time of the confirmation of the Plan, the confirming court found that the Bank was undersecured (Pet. App. 12a); that the Bank's counsel later represented that the Bank was undersecured (Pet. 9-10); and that the only judicial finding to the contrary is the decision by Bankruptcy Judge Weaver (Pet. App. 11a), made without any findings of fact whatsoever, that the Bank was not undersecured. It is this decision by Judge Weaver that petitioners attempted to obtain appellate review of in the district court and the court of appeals. The denial of appellate review to them by the district court and court of appeals is the subject of the present petition.

5. *The Respondents' Other Contentions are Without Merit.*—Finally, respondents make several arguments in

support of denying certiorari that seem rather to indicate that there are no solid bases to defend the judgment below. The trustee argues that the petition in this case is an impermissible "collateral attack on the confirmed plan." Smith Br. 16. Yet it was the *trustee* who brought this proceeding so that the issue of the Bank's credit for postpetition interest could be adjudicated.[4] And at the time he brought it, the Eleventh Circuit had already held that the debtors' appeal of the confirmation order was moot (because they did not post a multi-million dollar bond) and had adhered to that determination on rehearing. Pet. 11-12.

The trustee has a strange view of the judicial process: *he* is entitled to bring a declaratory judgment action to test the legality of the Bank's Plan years after the consummation of the Plan, but the defendants are not allowed to pursue the appellate process when a ruling adverse to them is entered in the court of first instance; indeed, according to the trustee, continued litigation of the issue that he himself raised is an impermissible "challenge" to the Plan (Smith Br. 16), consisting, he says, of the "shop-worn" argument that the "plan must comply with applicable statutory requirements." *Id.* at 19. Surely the trustee did not consider his declaratory judgment action seeking a resolution of whether the Plan complied with those very same "applicable statutory requirements" to be a challenge to the confirmation of the Plan or the sale of the property; instead he questioned whether the $27 million credit was lawful. Pet. 12. No

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[4] We note in passing that bringing and litigating the adversary complaints in this case, the tax case, and others is hardly consistent with the purportedly "ministerial" role that respondents (mistakenly) assert excuses the trustee from compliance with I.R.C. § 6012(b). Moreover, we question the propriety of the trustee's habit of taking positions in those litigations (and in the recent proceedings on the Trustee's Certificate, *see* p. 3 n.2, *supra*) that are seriously adverse to the debtors and the United States—who are, after all, beneficiaries of the Trust and supposedly to be protected by his status as a fiduciary. Perhaps the trustee's letter of indemnity from the Bank is showing.

Article III court had—or has—ever addressed that issue. But doing so will not require the unwinding of the Plan. Disgorgement by the Bank of the postpetition interest will not affect a single third party (except the United States, which will no longer face a substantial shortfall in the Trust).[5]

Respondents also make the curious argument that this Court's denial of certiorari from an earlier "mootness" decision somehow "precludes" the Court from considering this petition and acts as a binding adjudication on the merits under "principles of *res judicata*, collateral estoppel and the law of the case." BNY Br. 10-11 & n.12; Smith Br. 19. The decision of the court of appeals sought to be reviewed then had nothing to do with whether the Bank was undersecured or oversecured, and did not involve postpetition interest at all; it simply involved a pronouncement of the Eleventh Circuit of its notions of the "mootness" doctrine in another context. Moreover, respondents seem unaware that "this Court has rigorously insisted" that a denial of certiorari "carries with it no implication whatever regarding the Court's views on the merits of a case which it has declined to review. The Court has said this again and again; again and again the admonition has to be repeated." *Maryland* v. *Baltimore Radio Show, Inc.*, 338 U.S. 912, 919 (1950) (Frankfurter, J.). Contrary to respondents' contention, this Court's prior denial of certiorari does not "remotely imply approval or disapproval of what was said" by the court below. *Id.*[6]

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[5] While of course the trustee named the United States as a defendant in the tax case, he did not choose to name the United States as a defendant in the adversary proceeding from which the present petition arose. Thus the United States is not a party to the case here and has not made its views on it known to the Court, except to observe in its Reply in the tax case that the Bank and the trustee have raised the same "mootness" argument at issue here in their defense of the judgment below in the tax case. *See* p. 2, *supra*.

[6] Along these lines, the trustee makes an extended argument that "the doctrine of *res judicata* bars granting the writ" because the

Tellingly, *neither* respondent ever asserts that the Plan complies with the applicable statutory requirements. They argue, instead—as they did in opposing certiorari in the tax case—that it is now too late to do anything about the unlawful nature of the Bank's Plan because it has been implemented. Remarkably, the Bank states that this approach is needed by the "federal system" so that bankruptcy courts can quickly conclude reorganization proceedings. BNY Br. 16-17. In essence, the Bank seeks approval of a judicially created doctrine that effectively precludes Article III scrutiny of bankruptcy judges' decisions. Once a creditor's "cram down" plan is confirmed, unless the debtors post a bond, the entire case will be "moot" and Article III review improper. There is neither a need nor a rationale for such a rule. Indeed, if Congress

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Eleventh Circuit had earlier ruled that the debtors' appeal of the confirmation of the Plan was moot. Smith Br. 22-24. That assertion (which confuses the Court's authority to act with its judgment on the merits) is not only erroneous, it should not be considered at all. To begin, a finding that a case is moot cannot form the basis of claim (or even issue) preclusion because, by definition, such a finding prevents the entry of a "final judgment *on the merits*." *See Hughes Tool Co.* v. *Trans World Airlines, Inc.*, 409 U.S. 363, 365 n.1 (1973) (emphasis added). Instead, a finding of mootness "clears the path for future relitigation of the issues between the parties and eliminates a judgment, review of which was prevented through happenstance." *United States* v. *Munsingwear, Inc.*, 340 U.S. 36, 40 (1950); *accord Deakins* v. *Monaghan*, 484 U.S. at 200-01. Here, the Eleventh Circuit did just that when it dismissed the debtors' appeal of the confirmation order as moot and vacated the judgment below. *Miami Center Ltd. Partnership* v. *Bank of New York*, 838 F.2d 1547, 1558 (11th Cir.), *cert. denied*, 488 U.S. 823 (1988). Moreover, the theory that any claim for relief by the *debtors* would be barred under principles of claim preclusion is irrelevant here: it was the *trustee* who brought this action and the debtors have made no counterclaims against him. The plaintiff, having won below, cannot invoke the doctrine of *res judicata* to preclude appellate or certiorari review of the judgment in his favor. Finally, this novel theory was not pressed in or considered by the court of appeals; absent exceptional circumstances (none of which are identified here), this Court should not consider it. *See United States* v. *Lovasco*, 431 U.S. 783, 788 n.7 (1977); *Lawn* v. *United States*, 355 U.S. 339, 362-63 n.16 (1958).

had done explicitly what respondents suggest the courts should do, such a statute would have raised the serious constitutional question whether the "essential attributes of judicial power" had been retained in an Article III court. *See Northern Pipeline Constr. Co.* v. *Marathon Pipe Line Co.*, 458 U.S. 50, 77 (1982) (plurality opinion).

This case presents an integral part of the scheme exposed in the tax case, Nos. 90-1361 and 90-1484. In light of the admissions made by the Bank in its brief in opposition in the tax case (and respondents' defense of the judgment below in that case by reliance on the same "mootness" doctrine at issue in this case), certiorari should be granted in this case to review the "mootness" issues presented by this case. Review would prevent the decision of this Court in the tax case, should it be in favor of our contentions, from being an unavailing one because of the Bank's actions in receiving and retaining the postpetition interest. To paraphrase Judge Learned Hand's words in *Ewen* v. *Peoria & E. Ry.*, 78 F. Supp. 312, 325 (S.D.N.Y. 1948), "The tail [ought to go] with the hide."

For the foregoing reasons, and for the reasons stated in our petition, the petition for a writ of certiorari should be granted.

Respectfully submitted,

DENNIS G. LYONS
Counsel of Record
1200 New Hampshire Avenue, N.W.
Washington, D.C. 20036
(202) 872-6700

Of Counsel:
ARNOLD & PORTER
Washington, D.C., and
New York, New York

STUART E. SEIGEL
KENT A. YALOWITZ
65 East 55th Street
New York, New York 10022
(212) 750-5050
Attorneys for Petitioners

May 1991

APPENDIX

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UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF FLORIDA

Case No. 91-0953-CIV-RYSKAMP

IN RE HOLYWELL CORPORATION, *et al.*,
Debtors.

THE UNITED STATES OF AMERICA,
HOLYWELL CORPORATION, *et al.*,
Appellants,
v.
THE BANK OF NEW YORK and FRED STANTON SMITH,
Appellees.

On Appeal From the United States Bankruptcy Court for the Southern District of Florida

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[Filed May 16, 1991]

ORDER GRANTING STAY PENDING APPEAL

RYSKAMP, *District Judge*:

THIS CAUSE is before the court on emergency motion of appellants United States, et al., for stay. After careful consideration of the record, and having held oral argument in this matter, the court now issues the following memorandum order.

I. *Background*

The motion now before this court begins the latest in a long line of appeals arising out of a bankruptcy case that commenced nearly seven years ago. The appellants herein challenge the Bankruptcy Court's oral finding of April 25, 1991 and its written order of May 2, 1991, which determined that the liquidating trustee should execute and deliver to the Bank of New York ("the Bank") a trustee's certificate in the amount of $22,128,484.05. The present motion of the debtors and the United States seeks a stay of the Bankruptcy Court's decision pending resolution of the appeal to this court.

II. *Analysis*

In *Garcia-Mir* v. *Meese*, 781 F.2d 1450 (11th Cir. 1986), the Eleventh Circuit articulated a four-factor test to be used in evaluating a motion for stay pending appeal. *Id.* at 1453. For the movant to prevail on such a motion, this test requires a showing:

> 1) that the movant is likely to prevail on the merits on appeal; 2) that absent a stay the movant will suffer irreparable damage; 3) that the adverse party will suffer no substantial harm from the issuance of the stay; and 4) that the public interest will be served by issuing the stay. *Jean* v. *Nelson*, 683 F.2d 1311, 1312 (11th Cir. 1982) (per curiam), *see also*, 11th Cir. R. 17(b)(1).
>
> Ordinarily the first factor is the most important. A finding that the movant demonstrates a probable likelihood of success on the merits on appeal requires that we determine that the trial court below was clearly erroneous. *In re Grand Jury Proceedings*, 689 F.2d 1351, 1352 (11th Cir. 1982) (per curiam). But the movant may also have his motion granted upon a lesser showing of a "substantial case on the merits" when "the balance of the equities [identified

> in factors 2, 3, and 4] weighs heavily in favor of granting the stay." *Ruiz* v. *Estelle*, 650 F.2d 555, 565 (5th Cir. 1981) (per curiam), *cert. denied*, 460 U.S. 1042, 103 S. Ct. 1438, 75 L. Ed. 2d 795 (1983). *Id.*

A. *Likelihood of Prevailing on the Merits*

The appellants make several arguments in support of their contention that they are likely to prevail on the merits of this appeal. First, they argue that the basis for the issuance of a trustee's certificate is a funding agreement incorporated in an amendment to the plan of reorganization (the "second amendment") that was not approved by the bankruptcy court after notice and hearing. The Bank responds, in somewhat conclusory fashion, that "[t]here were no material amendments."

Second, the appellants argue that a prior Eleventh Circuit opinion in this matter, *In re Holywell Corp.*, 913 F.2d 873 (11th Cir. 1990), holding that the equitable subordination of claim 502 was unjustified was in effect a rejection of the Bank's argument that its obligation to pay that claim arose under the funding agreement. Therefore, appellants argue, the funding agreement is inapplicable, and may not serve as the basis for the issuance of a trustee's certificate. The Bank responds by noting that the Eleventh Circuit indicated a belief that a trustee's certificate had already been issued. *See In re Holywell Corp.*, *id.* at 877.

This court must conclude that there is a substantial likelihood that the appellants will prevail on the merits in this appeal. First, the fact that the second amendment was apparently never separately confirmed by the bankruptcy court after notice and hearing is a matter of serious concern. Second, the prior Eleventh Circuit opinion does suggest that the Bank is not entitled to a trustee's certificate, notwithstanding the erroneous dictum to the effect that a trustee's certificate had already been

issued. Finally, and most importantly at this juncture, the failure of the bankruptcy court to enter any findings of fact or to include any legal analysis in its May 2, 1991 order granting the Bank's motion for the issuance of a trustee's certificate makes it difficult for this court to presume that the issuance of the trustee's certificate is proper.

B. *Irreparable Damage*

The appellants argue that if the Supreme Court reverses the Eleventh Circuit decision that the trustee had no obligation to file federal income tax returns and pay federal taxes, there is a substantial likelihood, if the trustee's certificate is issued, that appellant United States will be unable to collect taxes due to the depletion of funds held by the trustee. Although the Bank correctly notes that the appellants' argument is based on the speculative contingency of the Supreme Court granting certiorari and reversing the Eleventh Circuit decision, the potential damage to the United States is severe and likely irreparable.

C. *Harm to the Adverse Party*

The bank argues that it "is prejudiced by every day of delay" in the conclusion of these cases. Although this may be true, the Bank itself must share responsibility with the other parties (and perhaps the courts) for the drawn-out nature of these proceedings. In any event, any harm caused by one further delay at this juncture is outweighed by the potential harm caused by denying a stay.

D. *The Public Interest*

Because the public interest in this matter appears to coincide with the interest of the United States (i.e., the collection of taxes), the public interest would be best served by granting the stay.

III. CONCLUSION

Based upon the foregoing analysis, it is hereby:

ORDERED and ADJUDGED that appellants' motion for stay is GRANTED. The order of the bankruptcy court, filed May 2, 1991, requiring the issuance and delivery of a trustee's certificate in the amount of $22,128,484.05 is therefore STAYED.

DONE and ORDERED in chambers at the United States District Court, Miami, Florida this 15th day of May, 1991.

/s/ Kenneth L. Ryskamp
KENNETH L. RYSKAMP
United States District Judge